D3.2 Form & Function of Money in Canada + Monetary Policy

Forms of Money in Canada

1. **Cash** – Physical money (bills & coins) issued by the Bank of Canada.
2. **Deposits** – Money in bank accounts used for transactions.

Functions of Money

✔ **Medium of Exchange** – Used to buy and sell goods/services.
✔ **Unit of Account** – Helps measure the value of things.
✔ **Store of Value** – Can be saved and used in the future.

Monetary Policy & Its Impact

Monetary Policy Tools (Used by the Bank of Canada):

- **Interest Rates** – Adjusted to control borrowing & spending.
- **Money Supply** – Managed to control inflation & economic growth.

Interest Rates and the Canadian Dollar (Exchange Rate Effect)

- **When Interest Rates Increase:**
    - Higher interest rates attract **foreign investors** looking for better returns on savings and investments in Canada.
    - This increases **demand** for the Canadian dollar (CAD) because investors need CAD to invest in Canadian bonds or deposits.
    - As demand for CAD rises, its **value (exchange rate) increases** compared to other currencies.
- **When Interest Rates Decrease:**
    - Lower interest rates make Canadian investments **less attractive** to foreign investors.
    - This reduces demand for CAD, causing its **value to drop** relative to other currencies.

Exchange Rates and Trade Balance

- **When the Canadian Dollar Increases in Value (Appreciates):**
  - Canadian goods and services become **more expensive** for foreign buyers (because they need more of their currency to buy CAD).
  - This reduces **exports** since foreign customers may switch to cheaper alternatives.
  - Meanwhile, **imports become cheaper** for Canadians because the stronger CAD buys **more foreign goods** at a lower cost.
  - **Result:** Trade balance may worsen as **exports decrease and imports increase**.
- **When the Canadian Dollar Decreases in Value (Depreciates):**
  - Canadian goods and services become **cheaper** for foreign buyers, boosting **exports**.
  - Imports become **more expensive** for Canadians, leading to a **decrease in imports** as consumers and businesses look for domestic alternatives.
  - **Result:** Trade balance may improve as **exports increase and imports decrease**.

Real-World Example:

- In 2015, the Bank of Canada **lowered interest rates**, which led to a **weaker Canadian dollar**.
- This made Canadian exports (like oil, lumber, and manufactured goods) **more competitive** in global markets, helping businesses sell more abroad.
- At the same time, **imported goods became more expensive**, encouraging Canadians to buy locally produced products.

D3.3 Role of Financial Institutions in Canada

Types of Financial Institutions

🏦 **Big Banks** – RBC, TD, Scotiabank, BMO, CIBC
🏛️ **Near Banks** – Trust & loan companies
📈 **Brokerage Firms** – Help buy & sell stocks
💳 **Credit Unions** – Member-owned banks

How Financial Institutions Work

✔ **Loans = Profit** – Banks lend money & earn interest.
✔ **Reserve Ratio** – Banks must keep some money in reserve for stability.
✔ **Brokerage Firms** – Offer expert investment advice & save investors time.

Sample Questions:

Question 1: How do market forces affect commercial lending rates? What impact can changes in these rates have on the economy?

B) Market forces decrease rates and stimulate the economy

C) Market forces increase rates and stimulate the economy

D) Market forces decrease rates and slow down the economy

Question 2: How can a change in interest rates affect exchange rates and trade?

A) Increase in interest rates leads to a decrease in the value of the Canadian dollar, making exports cheaper

B) Decrease in interest rates leads to an increase in the value of the Canadian dollar, making imports cheaper

C) Increase in interest rates leads to an increase in the value of the Canadian dollar, making exports more expensive

D) Decrease in interest rates leads to a decrease in the value of the Canadian dollar, making exports cheaper

Question 3: How do financial institutions generate money through loans?

A) By charging fees for services

B) By earning interest on loans

C) By selling stocks and bonds

D) By offering insurance policies

Question 4: Why might you want to know the reserve ratio for various banking institutions before you place your money in them?

A) To understand the profitability of the bank

B) To assess the stability and liquidity of the bank

C) To compare interest rates offered by different banks

D) To evaluate the customer service of the bank

Question 5: Why might an investor use a brokerage firm instead of making his or her own investment choices?

A) To save time and effort

B) To earn higher interest rates

C) To access insurance services

D) To get discounts on loans
